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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1950

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No. 211

NIAGARA HUDSON POWER CORPORATION, *Petitioner*

v.

M. VICTOR LEVENTRITT, *Respondent*

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No. 212

SECURITIES AND EXCHANGE COMMISSION, *Petitioner*

v.

M. VICTOR LEVENTRITT, *Respondent*

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**On Writs of Certiorari to the United States Court of Appeals for the Second Circuit.**

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## REPLY BRIEF FOR NIAGARA HUDSON POWER CORPORATION

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Dated: December 5, 1950.

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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In our main brief we argued that the Commission's findings were supported by substantial evidence and in that connection we interpreted the decision below as accepting the Commission's forecast that the average earnings for the future would leave $1.39 for the common stock of Niagara Hudson Power Corporation, assuming that corporation were to continue as a going concern. Since respondent is now apparently unwilling to accept this earnings forecast, which he did not challenge below, the basis of the

speculative contentions raised in respondent's brief requires, in the opinion of counsel, a short reply.

Although respondent did not bring to the court below the actual record which was before the Commission and the District Court, he now attempts, on the basis of dubious inferences gleaned from data in the Commission's findings, to paint a far more glowing picture of Niagara Hudson's financial future than that which the Commission accepted in the light of the entire record. Thus, apart from the contingencies which respondent imagines, including developments of atomic power, which he assumes would be a favorable rather than an unfavorable factor, an attempt is made to show that the actual record before the Commission indicates a value for the old Niagara Hudson common stock equal to or approaching the warrant exercise price within the near future.

Respondent translates a forecast on the part of Ebasco Services, Inc. of future earnings of Niagara Mohawk Power Corporation, the new operating company, into a prophecy on the part of Ebasco that if Niagara Hudson Power Corporation, the holding company, were to continue in existence there would be earnings for the year 1952 of $2.40 per share applicable to the existing Niagara Hudson shares upon which the warrant holders hold options.

As illustrated in Table VII (R. 66) of the Commission's Findings and Opinion, the Ebasco forecast indicated projected earnings for Niagara Mohawk Power Corporation in 1952 in the amount of $25,297,000. The Ebasco forecast is merely a projection of certain figures based upon a number of assumptions which are spelled out in the Commission's Findings (R. 67), including the raising of an additional $10,000,000 by Niagara Mohawk through the sale of common stock, and that forecast was made irrespective of the continuance or dissolution of Niagara Hudson, the holding company. This forecast was considered too high by the Commission (R. 69-71), and, as we show below, is not immediately translatable into the present investment of the

common shares of the holding company if the latter were continued in existence.

Respondent gives no breakdown of the computations by which he translates the Ebasco forecast into present share earnings for the existing Niagara Hudson common stock. We assume that in arriving at the figure of $2.40 per share, respondent first deducted from the $25,297,000 projected Niagara Mohawk earnings the sum of $2,314,000 representing the dividend requirements on the Class A stock of the new operating company, and divided the balance, $22,983,000, by the 7,473,172 shares of common stock of the new operating company initially to be issued and outstanding pursuant to the plan. The resulting figure of $3.08 per share was presumably then multiplied by respondent by .78, since under the Plan the holder of each share of Niagara Hudson common stock is entitled to receive .78 shares of Niagara Mohawk common stock upon dissolution, and from these computations respondent apparently derives approximately $2.40 per share for the Niagara Hudson common stock.

So far as we are able to ascertain, respondent's computations ignore entirely the assumption on the part of Ebasco that to realize the projected earnings, Niagara Mohawk would have to raise an additional amount of equity capital of $10,000,000. It is, of course, merely a matter of speculation as to whether, assuming that Niagara Hudson would continue in existence, the additional equity capital would be raised by the sale of additional Niagara Mohawk or Niagara Hudson stock or as to the price at which such stock would be sold. In any event, the earnings of the new operating company attributable to the common stock of the holding company would be substantially less than respondent's computations indicate.

If we assume that $10,000,000 of new equity capital were raised through the sale of an additional 500,000 shares of Niagara Mohawk common stock at $20 per share (which is approximately the present market) and also assume that

none of the Class A were converted into Niagara Mohawk common stock (which is contrary to the fact), the earnings per share available to the Niagara Hudson common stock on the .78 ratio, after adjustment for the $750,000 estimated annual expenses of the holding company (R. 81), would be only $2.17 per share as opposed to the $2.40 computed by respondent.

Furthermore, to make the point that Niagara Hudson stock might one day sell at or near the exercise price of the warrants, $42.86 per share, respondent assumed that the stock would sell at 17.86 times earnings. There is no support in the record for the assumption that the common stock of a holding company would at any time in the foreseeable future sell at 17.86 times earnings. In fact, the Commission concluded that a 15 times earnings ratio was "very liberal" (R. 82) and the court below took a figure of 15 times the annual dividend (R. 124). Upon all assumptions most favorable to respondent, the earnings available to the Niagara Hudson common stock on the basis of a translation of the Ebasco forecast would thus, as has been illustrated, be $2.17 per share. Applying the 15 times earnings ratio, which the Commission found to be very liberal, the result would be only $32.55, or about $10 less than the exercise price of the option warrants.

In short, it is evident that any attempt to relate future earnings on Niagara Hudson common stock to the Ebasco forecast for the new operating company is dependent upon assumptions, speculations and adjustments of the kind indicated above which are not demonstrable by the slide rule approach adopted by the respondent. The Commission found that $1.39 per share was a reasonable forecast for the average annual earnings attributable to the common stock of Niagara Hudson Power Corporation if it were to continue in existence. This determination was made upon all the evidence in the record and in the exercise of the Commission's expert judgment. This finding is not now subject to review by this Court on the basis of an incom-

plete record and where the court below accepted the earnings forecast of the Commission, which forecast respondent did not challenge.

Respondent urges that the warrant should be valued on the same basis as that adopted by this Court in the *Engineers* case for valuing a preferred stock, namely, the cost of its replacement by a new security of comparable risk. See *SEC.* v. *Central Illinois Securities Corp.*, 338 U. S. 96, 144-146. We fail to see how the approach in the *Engineers* case is relevant to respondent's contentions here. As this Court there said, "The standard of compensation to be accorded security holders does not depend upon whether their security interests are to be retired by exchanging them for new securities in a continuing enterprise or by payment in cash." 338 U. S. at 143. The Commission having found that, on a rational hypothesis of future earnings, the warrants of Niagara Hudson had no present investment value, the warrant-holders were properly excluded from any participation, whether in kind or in cash. Since, as we have urged, the Commission was correct in concluding that it was impossible to make a rational appraisal that the warrants would ever reach the exercise price, it was equally impossible for it to make a rational comparison of the Niagara Hudson warrants with other warrants representing different and unrelated gambles. What respondent suggests is that, since the warrants are being eliminated, the Act requires that the common stockholders of Niagara Hudson furnish the warrant-holders with money to speculate in warrants of other companies. In *Ecker* v. *Western Pacific Railroad Corp.*, 318 U. S. 448, 475-476, this Court has specifically rejected the argument that claims of security holders, having no value, were entitled to participation by the issuance of warrants through which they might possibly recoup their losses as a result of unanticipated future earnings. By the same token, the warrant-holders in this case cannot insist upon a cash payment by which they might recoup their losses elsewhere in the market.

The extremity of respondent's position is indicated by his assertion (page 30 of his brief), where he claims "In a legal sense, option warrant holders, as well as creditors and preferred stockholders, are 'prior' to the common stockholders." This is a far cry from the provision of the option contract (R. 145) that the "warrant does not entitle the holder thereof to any rights whatsoever as a stockholder of the Corporation."

Respondent seeks participation upon the basis of "unforeseen" and "unanticipated earnings." That is directly contrary to all rulings of this Court.

Respectfully submitted,

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*Counsel for Petitioner.*

Dated: December 5, 1950.